No. 10061

IN THE

United States Circuit Court of Appeals

FOR THE NINTH CIRCUIT

UNITED STATES OF AMERICA,

Appellant

vs.

THE COAST WINERIES, Inc., a corporation, and UNITED STATES FIDELITY AND GUARANTY COMPANY, a corporation,

Appellee.

UPON APPEAL FROM THE DISTRICT COURT OF THE UNITED STATES FOR THE WESTERN DISTRICT OF WASHINGTON, NORTHERN DIVISION

BRIEF FOR APPELLANT

JOSEPH LAWRENCE,
Director, Bond and Spirits Division, Department of Justice.

BENJAMIN H. PESTER,
Chief, Bond and Tax Section.

J. CHARLES DENNIS,
United States Attorney.

JULIAN D. SIMPSON,
Chief, Compromise Section.

GERALD SHUCKLIN,
Assistant United States Attorney.

THOMAS R. WINTER,
General Counsel Representative.

OFFICE AND POST OFFICE ADDRESS:
1021 UNITED STATES COURT HOUSE.
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UPON APPEAL FROM THE DISTRICT COURT OF THE UNITED STATES FOR THE WESTERN DISTRICT OF WASHINGTON, NORTHERN DIVISION

BRIEF FOR APPELLANT

STATEMENT OF THE PLEADINGS, FACTS AND PROCEDURAL STEPS DISCLOSING JURISDICTION

This case arises on appeal from decision (R. 51-58) and judgment entered by the District Court of the United States for the Western District of Washington, Northern Division (R. 71-72).

JURISDICTION OF DISTRICT COURT

This appellant, The United States of America, as alleged, was complainant in the Court below (R. 2), under authority of Sec. 41, Title 28 U.S.C.

The Coast Wineries, Inc. was a corporation doing business under the laws of the State of Washington, with the principal place of business at Yakima, Washington, and the United States Fidelity and Guaranty Company is a corporation organized under the laws of the State of Maryland, duly authorized to do a general surety business in the State of Washington (R. 2-3).

The complaint was filed by the United States Attorney for the Western District of Washington on behalf of the United States of America, appellant, for the recovery of $3,162.56 under two bonds executed by the defendants named, to the United States of America (R. 5-9) as set out in the complaint.

JURISDICTION OF THIS COURT

The appellee, United States Fidelity and Guaranty Company, defendant below, filed an answer and thereafter an amended answer to the complaint admitting certain allegations in the complaint and denying

others (R. 28-46). They also alleged a counterclaim or set-off, to which this appellant filed a reply (R. 46-51). A trial was had on May 7, 1941, to the Court without a jury (R. 81), and judgment was entered on July 7, 1941, against the appellant dismissing the action with prejudice (R. 71-72). Notice of appeal was filed in the United States District Court for the Western District of Washington, Northern Division, on October 6, 1941, (R. 73), and a motion for extension of time to file the transcript of record was filed in this Court (R. 74). Motion was granted on February 5, 1942 (R. 76-77). Transcript of Record was filed February 18, 1942 (R. 79-80). Jurisdiction of this Court is under Sec. 128(a) of the Judicial Code, as amended by the Act of February 13, 1925, (Title 28 U.S.C. Sec. 225).

STATEMENT OF THE CASE

QUESTIONS PRESENTED

Five questions are raised by this Appeal:

1. Is the finding of fact, numbered IX, made by the District Court, that the $9,387.21 claim, was withdrawn pursuant to an agreement between the attorney for the appellant and the attorney for the trustee in consideration of the withdrawal of objections to the other claims by the trustee, erroneous?

2. Is the appellant estopped to assert a claim upon the bonds against the United States Fidelity and Guaranty Company?

3. Is the order of Judge J. Stanley Webster, dated November 12, 1937, in the bankruptcy proceeding of the Coast Wineries, Inc., res judicata between plaintiff below and the defendant United States Fidelity and Guaranty Company?

4. Is the claim for $732.22 paid to the trustee as alleged by the appellee a proper set-off in this bond suit against the surety for the bankrupt?

5. Did the District Court err in dismissing this action?

STATUTES INVOLVED

"SEC. 3770. AUTHORITY TO MAKE ABATEMENTS, CREDITS, AND REFUNDS. (Sec. 3770, I.R.C.—Sec. 3220 R.S.) parenthesis ours.

(a) TO TAXPAYERS.—

(1) Assessments and collections generally.—Except as otherwise provided by law in the case of income, estate, and gift taxes, the Commissioner, subject to regulations prescribed by the Secretary, is authorized to remit, refund, and pay back all taxes erroneously or illegally assessed or collected, all penalties collected without authority, and all taxes that appear to be unjustly assessed or excessive in amount, or in any manner wrongfully collected."

STATEMENT OF FACTS

This is a suit by the United States of America against the United States Fidelity and Guaranty Company on two winemakers' bonds executed by the Coast Wineries, Inc., as principal and the United States Fidelity and Guaranty Company, as surety, which said bonds guaranteed payment to the United States of America of certain taxes incurred by the Coast Wineries, Inc., in the making and selling of wines at 313 West C Street, Yakima, Washington (R. 5-8). The complaint alleges a breach of the conditions of the bonds through the failure to pay taxes in the sum of $3,163.56 as evidenced by an assessment on the books of the Collector of Internal Revenue at Tacoma, Washington (R. 4). The assessment of this tax is established by the record and was so found by the Court in the case at bar (R. 61).

The defendant appellee, United States Fidelity and Guaranty Company, filed an answer to the complaint, and later filed an amended answer to said complaint, wherein it admits the execution of the bonds, but denies that the bonds were in effect at the time the Coast Wineries, Inc, incurred the tax, and denies that an assessment for taxes at 30c per gallon on 10,541 proof gallons of wine was entered on the Col-

lector's books, and alleges its refusal to pay the taxes claimed by the United States of America (R. 29-30).

The amended answer further alleges that the Coast Wineries, Inc. was adjudicated a bankrupt and a claim was filed by the Collector of Internal Revenue in the bankruptcy proceedings for the sum of $9,387.21, and that pursuant to a claim for abatement of said tax, the claim was withdrawn on October 15, 1935, (R. 32) by letter of the Collector of Internal Revenue (R. 41). That, thereafter on April 15, 1937, a claim in the sum of $3,162.56 was filed with the United States Clerk for the Eastern District of Washington, Southern Division, in the matter of the bankruptcy of the Coast Wineries, Inc., and that said claim was disallowed and rejected by the trustee in bankruptcy; that said claim came on for allowance or disallowance upon the report of the Special Master before the Honorable J. Stanley Webster, Judge of the United States District Court for the Eastern District of Washington, Southern Division, on October 5, 1937, (R. 33); that the United States was represented by an Assistant United States Attorney and after a hearing an order was entered on November 12, 1937, denying and expunging said claim (R. 34), and that no appeal was taken (R. 34) from said order (R. 44-45).

The amended answer further alleges, the death of one of the surety's indemnitors (R. 35) and a set-off and counterclaim for $737.22 (R. 36-37).

The appellant filed a reply admitting that the claim sued for is the identical amount of taxes set forth in the claim filed in the bankruptcy matter but denied the other allegations, and denied that a hearing was had on said claim, alleging that the claim was disallowed and expunged on oral objection of the trustee to the filing of the claim (R. 48) for the reasons stated in the order (R. 45).

The pleadings and evidence of record tend to show that the Coast Wineries, Inc., filed a petition in bankruptcy for reorganization under Section 77-B of that Act, and the United States Collector of Internal Revenue for the District of Washington filed three claims in said bankruptcy proceedings, namely; one for $501.67, another for $9,387.21 and a third claim for $76.20 (R. 94). The plaintiff, appellant herein, objected to the introduction of this testimony (R. 94) and the Honorable Judge reserved his ruling on the question (R. 95-97).

Over objection of appellant's counsel, Thomas E. Grady was permitted to testify regarding a conversation he had had with Thomas Winter, Special At-

torney for the Internal Revenue Bureau, to the effect that the objections of the trustee to the $501.67 and the $76.20 claims would be withdrawn if the United States Government would withdraw its claim in the sum of $9,387.21 (R. 100-103), and that thereafter the abatement claim was allowed for $6,224.65 (R. 109). Thomas R. Winter took the witness stand and denied any conversation or agreement had with Thomas E. Grady regarding the two smaller claims (R. 137-138). The Special Master's report shows that the $9,387.21 claim was disallowed and expunged and the other two claims were allowed (R. 65), and said report was approved by the Court (R. 66).

On or about April 13, 1937, the Collector of Internal Revenue filed with the Clerk of the Court in the bankruptcy matter of the Coast Wineries, Inc. a claim for $3,162.56, which said claim was a part of, and had originally been included in the $9,387.21 claim (R. 54 and 67). On November 12, 1937, this claim was expunged and disallowed by the District Court in the bankruptcy proceedings because it "was and is a part of the original claim of $9,387.21" (R. 54).

SPECIFICATIONS OF ERROR AND POINTS TO BE URGED

1. The Court erred in finding as a fact, that the $9,387.21 claim filed in the bankruptcy reorganization proceedings was withdrawn pursuant to an agreement between the attorney for the Government and the attorney for the trustee.

2. The Court erred in concluding, as a matter of law, that the appellant is estopped to assert the claim, sued upon, against the United States Fidelity and Guaranty Company.

3. The order of Judge J. Stanley Webster, dated November 12, 1937, and the other proceedings had in the bankruptcy matter of the Coast Wineries, Inc. is not res judicata.

4. The claim of the Appellee for $732.22, the amount paid to the trustee, is not a proper set-off in the suit on the bond.

5. The Court erred in dismissing the suit and not entering judgment for the amount sued for by the United States of America.

SUMMARY OF ARGUMENT

1. Under the pleadings filed no issue was set up regarding an agreement as the basis for the with-

drawal of the $9,387.21 claim originally filed in the bankruptcy reorganization proceedings, and the evidence introduced over the objections of appellant's counsel erroneously forms the basis for the Court's finding of fact, that there was an agreement.

2. The Commissioner of Internal Revenue is the only Government officer who has the authority to abate a tax and bind the United States of America in the matter of assessed taxes and, therefore, any agreement which any special attorney of the Internal Revenue Bureau may or may not have made, would not and could not constitute an estoppel.

3. The $9,387.21 claim was withdrawn by the Collector of Internal Revenue from consideration in the bankruptcy reorganization matter and the $3,162.56 claim was part of the $9,387.21 claim and was filed as a new claim in the bankruptcy matter of the Coast Wineries, Inc., after the Court had approved the report of the Special Master in which the larger claim had been expunged and disallowed. The smaller claim was therefore a non-provable claim before the Special Master and its disallowance is not res judicata.

4. The counterclaim of the appellee for $732.22 arose out of a refund paid to the trustee in bankruptcy for tax stamps purchased after the Coast

Wineries, Inc., became a bankrupt and is, therefore, not allowable as a set-off in the suit against the surety on the bonds executed by the bankrupt taxpayer for payment of taxes incurred prior to the bankruptcy.

5. The doctrine of estoppel and res judicata have no application to what transpired in the bankruptcy proceeding as appears in the record and the appellant can, therefore, maintain its suit on the bonds.

ARGUMENT

I.

THE COURT ERRED IN FINDING AS A FACT THAT THE $9,387.21 CLAIM FILED IN THE BANKRUPTCY REORGANIZATION PROCEEDINGS WAS WITHDRAWN PURSUANT TO AN AGREEMENT BETWEEN THE ATTORNEY FOR THE APPELLANT AND THE ATTORNEY FOR THE TRUSTEE.

In the trial of this case the Court, over objection of the plaintiff's counsel (R. 94), permitted Judge Grady, who had been the attorney for the trustee in bankruptcy, to testify in effect that he and Mr. Winter, attorney for the Government, discussed the merits of these claims, and that it was agreed that the objections of the trustee to claims numbered 1 ($501.67) and 3 ($76.20) would be withdrawn, since the claim

of $9,387.21 was to be withdrawn by the United States of America. Mr. Winter's testimony in the Court below not only denies any such agreement, but even the discussion.

Based upon this testimony, the Court found as a fact, "pursuant to an agreement by the attorney for the plaintiff herein and the attorneys for the trustee in bankruptcy of the Coast Wineries, Inc. the trustee withdrew his objections to the claims of $501.67 and $76.20, and the $9,387.21 was withdrawn by the Government as evidenced by written notice from the Collector of Internal Revenue." (R. 64).

The amended answer of the appellee, United States Fidelity and Guaranty Company, does not allege any such agreement, and under the allegations set out in the pleadings such question of fact was not properly before the Court.

The amended answer of appellee alleges the withdrawal of said claim in the bankruptcy reorganization proceedings, together with the documentary evidence relating to the withdrawal of said claim, and the order of the Honorable J. Stanley Webster, United States District Judge for the Eastern District of Washington, dated November 12, 1937.

The testimony of Thomas E. Grady (R. 92-119), which forms the basis of the finding of fact by the lower Court, that such agreement was entered into, was objected to by the appellant (R. 94) and the Court reserved its ruling on this objection (R. 95).

The defendant not having alleged an agreement as the basis for the withdrawal of the $9,387.21 claim, but having alleged that the order of the Honorable Judge Webster, dated November 12, 1937, was an adjudication of this claim, should not have been allowed to assert such agreement at the trial. We submit, therefore, that all of the testimony introduced relating to the proceedings had in the bankruptcy reorganization matter as to the reason for the withdrawal of the $9,387.21 claim was irrelevant and immaterial and should have been ruled out by the Court.

Parties must confine their proof to the pleadings, *Strauss v. J. M. Russell Company*, 85 Fed. 589-592. In *Oklahoma Gas and Electric Company v. Bates Expanded Steel Truss Company*, 296 Fed. 281-283, the Court said: "Turning from definitions of the terms to the rules pertaining to the admission of evidence, we find that a most fundamental rule is that evidence offered must correspond with the allegations and must be confined to the points in issue. *Greenleaf on*

Evidence par. 51. A statement of a witness is not relevant unless it touches upon the issue which the parties have made by their pleadings. *Platner v. Platner*, 78 N. Y. 90-95."

The finding of fact that the claim was withdrawn *pursuant to such an agreement* is erroneous and not warranted by the pleadings and evidence relative to this case.

Furthermore, the notice of withdrawal sent to the Clerk of the Court shows upon its face that the claim was withdrawn upon the recommendation of the District Supervisor of the Alcohol Tax Unit (R. 41), and the testimony in the case (R. 153) shows that the Collector had no authorization in his office at the time. It must be here remembered that the Commissioner of Internal Revenue alone is the official authorized by statute to either assess or abate taxes of (Sec. 3770 I.R.C.) this character. Therefore, neither the District Supervisor nor the Collector of Internal Revenue had any right or authority to bind the Commissioner of Internal Revenue at any stage prior to his final action and notification to his field subordinate.

II.

THE COURT ERRED IN CONCLUDING, AS A MATTER OF LAW, THAT THE APPELLANT WAS ESTOPPED TO ASSERT THE $3,132.56 CLAIM SUED UPON, AGAINST THE U. S. FIDELITY AND GUARANTY COMPANY.

Aside from the question of estoppel by judgment, (res judicata), the United States is not otherwise estopped by any alleged actions of its officers from now recovering judgment for the amount equal to the taxes unpaid by the Coast Wineries, Inc., and thus a charge against the appellee, the United States Fidelity and Guaranty Company.

As stated in point I, nowhere in the pleadings either the complaint of the United States (R. 2-9), or in the answer (R. 10-27), or the amended answer, (R. 28-46) or in the reply of the Government (R. 46-51), is any mention of any alleged agreement by Government counsel with the trustee or his attorney concerning the withdrawal of the original $9,387.21 tax claim (R. 39-40), or that such tax claim would be withdrawn if the objections by the trustee to the payment or two other small tax claims, to wit: $76.20, documentary tax, and $501.67 capital stock tax, claims for which had also been filed by the Collector with the Special Master (R. 52-62), were with-

drawn. Therefore, since issue could not be, and was not joined, the District Court erred in admitting over the objection of Government Counsel any testimony or evidence concerning such alleged agreement. The Court further erred in permitting testimony regarding the claims filed with the Referee in Bankruptcy for the $76.20 and $501.67 above mentioned (R. 94 etc.). Consequently, the District Court further erred in concluding there was such agreement between the attorney for the Government and the attorney for the Trustee in Bankruptcy (R 53), and in the Findings of Fact and Conclusions of Law (R. 64) to like effect. This was clearly prejudicial to the Government's case, especially since in part the Court's decision was based on estoppel, otherwise than by res judicata (R. 70).

Even admitting all the facts alleged by defendant in its amended answer, and those established by the record of testimony heard in the District Court in the instant case, such facts could not and did not establish estoppel, so as to prevent an action to recover a debt due the United States. The only officer of the United States authorized by statute to finally pass on claims for abatement of taxes and refund is the Commissioner of Internal Revenue (Section 3770 I.R.C.). This, the Trustee in Bankruptcy well knew, or should have known, and with this knowl-

edge the defendant, appellee in the instant suit, namely, the United States Fidelity and Guaranty Company, is therefore chargeable. As was stated in *Schafer v. Helvering*, 83 F. (2d) 317;

> "Wrongs between man and man, which shock the conscience and justify the intervention of a Court of Equity, cannot affect or prejudice the sovereign in the right to demand the full measure of the statute. Whoever deals with the Government does so with notice that no agent can, by neglect or acquiescence, commit it to an erroneous interpretation of the law."

The United States is not bound by unauthorized acts of its agents. Thus in *Alkan v. Bean*, Fed. Cas. No. 202, cited with approval in *U. S. v. Rizzo*, 297 U. S. 530, the court said in a really hardship case;

> " * * * The lien in favor of the United States *could not be* waived or affected by any statements made by the Collector or his deputy, to the complainant, Alkan, to the effect that the government had no claim against the property, and that there were no unpaid taxes thereon. No such statements or representations could estop the Government from asserting any claim (it actually had) or any lien existing in its favor for unpaid taxes * * *. *If such representations or statements were made, they could not bind the Government or effect its rights.* * * *" (Italics ours)

So, also to the effect that the United States is not bound or estopped by the acts of its officers and agents in entering into an agreement, or arrangement to do

or cause to be done what the law does not sanction or permit: *Wibur Nat. Bank v. U. S.* 294 U. S. 120, 79 L. Ed. 798; and *Utah Power and Light Co. v. U. S.* 243 U. S. 289, 61 L. Ed. 791. So, also, the Court concluded in *Utah v. U. S.* 284 U. S. 534, 76 L. Ed. 469, (a case where a land patent had issued on representations of certain citizens that the land was agricultural, whereas it was later ascertained by the United States to be mineral), that statements made by a Special Assistant Attorney General in a conversation with a State Official, could not constitute estoppel. Nor could a mistake of Government officers in construing a reservation in a land grant, establish estoppel, *Dubuque & S.C.R. Co. v. Des Moines Valley R. Co.*, 109 U.S. 329, 27 L. Ed. 952 And, further, where statements were admittedly made by Departmental Officers to the effect that a claim would be allowed, or had been certified favorably to the auditing office, the Court notwithstanding found no ground for estoppel against the United States. *Christie-Street Co. v. U. S.*, 129 F. 506, aff. 136 F. 326. So, too, the Collector of Internal Revenue had no authority to advise a taxpayer that he would not be required to pay a special tax, *Brabham v. Cooper*, 9 F. Supp. 904. Also, where an officer stood by and permitted repairs to be made of

a seized vessel, the United States was not estopped to assert its prior claim, *La Mascotte* 6 F. Supp. 695.

Thus, the general rule is that the United States is not bound by the unauthorized acts or statements of its agents.

McDonald v. U. S., 89 F. (2d) 126, Cert. denied 301 U. S. 697;

U. S. v. Norton, 77 F. (2d) 731.

And finally the case of *Royal Indemnity Co. v. U. S.*, 313 U. S. 289, seems in point regarding estoppel. There a Collector of Internal Revenue was paid by a bonding company the full amount of the tax for which the bond was liable (the bond in the instant case guarantees payment of taxes also) and surrendered the bond to the bonding company and consented to its termination. Thereafter the Government sued for interest. The Supreme Court sustained the Government's claim. The Court held that the Collector was a subordinate officer and that, while the Collector was authorized to accept the bond, his action in surrendering and terminating the liability on the bond was not authorized and, therefore, not binding on the United States. The Court said:

> "Power to release or otherwise dispose of the rights and property of the United States is lodged in the Congress by the Constitution. Art. IV 3, Cl. 2. Subordinate officers of the United States

are without that power, save only as it has been conferred upon them by Act of Congress or is to be implied from other powers so granted. (Citing cases) Collectors of internal revenue are subordinate officers charged with the ministerial duty of collecting the taxes. (Citing cases) There is no statute in terms authorizing them to remit taxes, to pass upon the claims for abatement of taxes or to release any obligation for their payment. Only the Commissioner, with the consent of the Secretary of the Treasury, is authorized to compromise a tax deficiency for a sum less than the amount lawfully due. (Citing cases)

"There is thus no basis in the statutes of the United States for implying an authority in a collector to release a bond for the payment of the tax which the Commissioner alone is permitted to reduce by way of compromise when the Secretary of the Treasury consents. *Heinemann Chemical Co. v. United States*, *supra*, and *Brewerton v. United States*, Ct. Cl., 9 F. Supp. 503, to the contrary, plainly rest upon a misapplication of the ruling in *United States v. Alexander*, 110 U. S. 325, 4 S.Ct. 99, 28 L.Ed. 166, which sustained the release of a bond for taxes by the Secretary of the Treasury which had been specially authorized by an Act of Congress."

Therefore, it is respectfully submitted that any alleged actions by Government officers contrary to their actual authority did not, and could not, constitute estoppel as barring the right of the United States in this action.

III.

THE ORDER OF JUDGE J. STANLEY WEBSTER, DATED NOVEMBER 12, 1937, AND THE OTHER PROCEEDINGS HAD IN THE BANKRUPTCY MATTER OF THE COAST WINERIES, INC. IS NOT RES JUDICATA.

The record discloses that the $9,387.21 claim originally filed in the bankruptcy reorganization proceedings was withdrawn (R. 45 and R. 53). The Special Master made his report to the District Judge as follows:

> "Claim No. 69 filed by the United States Collector of Internal Revenue in the amount of $9,387.21 has been withdrawn (Trustee's Exhibit J).
>
> This claim represented a tax on distilled spirits assessed under Sections 3244 and 3176 of the Revised Statutes and under the Liquor Taxing Act of 1934, the tax was abated under date of October 15, 1935." (R. 65).

This report was approved by District Judge J. Stanley Webster on December 21, 1936 by Memorandum Opinion (R. 66).

Thereafter on April 15, 1937, the United States of America filed a new claim in the sum of $3,162.56 with the United States Clerk in the matter of the bankruptcy of Coast Wineries, Inc. (R. 32 and R. 67). On or about October 5, 1937, the matter of the claim

of $3,162.56 came on before the Court for disallowance upon the oral motion of the trustee in bankruptcy (R. 54), and on November 12, 1937, by order of Judge J. Stanley Webster, the said claim was expunged and disallowed (R 55) for the reason that this claim "was and is a part of the original claim of $9,387.21 which was filed by the Collector of Internal Revenue for the District of Washington on or about February 28, 1935, and which claim the said Collector of Internal Revenue advised the Special Master in Chancery by letter of October 15, 1935, was abated on his records and thereby withdrawn, and it appearing that the said Special Master has disallowed and expunged said claim in his report ($3,162.56) to which the exceptions were taken by the claimant, and which report to that extent has been approved by this Court in its memorandum decision on file herein." (R. 54).

From the above, it is definitely shown that the Special Master expunged the $3,162.56 claim from the record because it was and is a part of the $9,387.21 claim which had been previously withdrawn and expunged from the record, and so reported to the District Court, and which said report had been approved by the District Court and the claim expunged. It is obvious that neither the $9,387.21 claim, nor the $3,-

162.56 claim, which was a part of the $9,387.21 claim, were ever considered on their merits, either by the Special Master or by the Court. The $9,387.21 claim was withdrawn, and the $3,162.56 claim disallowed and expunged, because it was a part of the $9,387.21 claim which had been previously withdrawn and for that reason expunged. No estoppel by record can be invoked where the allegations or recitals did not conclude the pleader in the prior proceedings, as where the action was discontinued or dismissed without a decision on the merits. *Owensboro v. Waterworks*, 243 U. S. 166.

The decisions are clear that both in bankruptcy proceedings and in other court proceedings the plaintiff may withdraw its claim or action without prejudicing further action to enforce the collection of the obligation providing that the defendant will not be prejudiced other than by defending a subsequent action. See:

> *Jones v. Sec. Ex. C.* 298 U. S. 1, *Detroit v. Detroit City Ry.* 55 Fed. 569 and *Ex Parte Skinner and Eddy Corp.* 265 U. S. 86.

In the last mentioned case the Court stated,

> " * * * The right to dismiss, if it exists, is absolute. It does not depend on the reasons which the plaintiff offers for his action. The fact that he may not have disclosed all his reasons, or may not have given the real ones, can not affect his right.

> The usual ground for denying a complainant in equity the right to dismiss his bill without prejudice at his own costs, is that the cause has proceeded so far that the defendant is in a position to demand on the pleadings an opportunity to seek an affirmative relief, and he would be prejudiced by being remitted to a separate action. * * "

It may be noted that in bankruptcy matters, rules of law and equity are applicable. See also *Pennsylvania Globe Gaslight Co. v. Globe Gaslight Co.* 121 Fed. 1015. Other cases may be cited substantiating the principle of permitting withdrawal of claims and their subsequent reassertion in a new proceeding.

The correct ruling, for the determination of whether the disallowance of a claim in bankruptcy is res judicata has been laid down in *United States v. American Surety Company of New York*, 56 Fed. (2d) 734, (C.C.A. 2), where the Court said:

> "It may also be conceded that the allowance or disallowance of a claim in bankruptcy should be given like effect as any other judgment of a competent court, in a subsequent suit against the bankrupt or any one in privity with him. * * * But the distinction must be noted between disallowance of a claim because the creditor had a non-provable debt and disallowance because he had no debt at all. Disallowance on the former ground decides nothing as to the merits of the claim."

To like effect see *Lesser v. Gray* 236 U. S. 70.

In the case at bar the Court found in its find-

ings of fact that there was an assessment for $3,-162.56 and the assessment of the tax was not controverted. The decision was rendered solely on the basis that the new claim as filed being a part of the $9,-387.21 claim expunged, was not subsequently provable in the bankruptcy proceedings.

In the case of *Bowers, etc. v. American Surety Company*, 30 Fed. (2d) 244 (writ of certiorari denied, 279 U. S. 865), bond was given, pending claim for an abatement of the tax assessment, guaranteeing payment of the tax if the claim for abatement was refused. Principal was then declared bankrupt, and upon the disallowance of the claim for abatement, and the refusal of the Government to file a claim against the bankrupt estate, the surety in the name of the Government, under 11 U.S.C.A. Section 93, filed the claim. Same was disallowed by the Bankruptcy Court. The surety, upon being sued under its bond for the tax, contended the foregoing action created equities forbidding recovery. The court said:

> "Moreover, the issues decided by the Bankruptcy Court were irrelevant in any event; they concerned, and could concern, only the question of whether the tax had been properly assessed, not whether it had been assessed at all."

The suit, in this case, predicated upon the bond executed by the United States Fidelity and Guaranty

Company, guaranteeing that "the said principal shall well and truly pay all the taxes due on said wine at the time and in the manner required by said laws and regulations," must be distinguished from a suit for taxes and considered as a suit on a contract for debt.

U. S. v. Barth Co., 279 U. S. 370;

Gulf State Steel Co. v. U. S. 287 U. S. 32;

Gray Motor Co. v. U. S. 16 F (2d) 367;

U. S. v. Wyoming Central Association, 70 F (2d) 869.

The decision of the Bankruptcy Court, therefore, cannot operate to bar recovery of the liability under the bond.

The $9,387.21 claim having been expunged by the Court in its final order in the bankruptcy proceeding, and the new claim being a part thereof, and no motion having been made to the Court to reinstate the $3,162.56 portion as a part of the $9,387.21, reported by the Collector as having been abated in error, the Special Master could not and did not consider the $3,162.56 on its merits, nor did the Court pass upon the merits of this new claim for $3,162.56, according to the findings in the record, because the same was a part of the $9,387.21 claim already expunged by it.

It is conceded, if the action by the Special Master and by the District Court in expunging the claims for $9,387.21 and $3,162.56 respectively, had been conclusive on the Government, the matter would have been res judicata. See:

Johannessen v. U. S. 225 U. S. 227, 56 L. Ed. 1066 and *Southern Pacific Railway Co. v. U. S.* 168 U. S. 1, 42 L. Ed. 355.

However, as in the case at bar the disallowance of a smaller claim because of the withdrawal and expunging of a larger claim, of which the smaller claim was part, does not decide the merits of either claim or constitute res judicata. Thus, it is clear that the taxpayer was not relieved from its liability for the tax under these circumstances. Since the claim was withdrawn, the decision in the matter of the bankruptcy still left the Government with its right to proceed to collect the amount actually due under the bond. In other words, the situation was that there was no provable claim before the Bankruptcy Court which could have been allowed and the discharge of the estate in bankruptcy does not conclude the Government from now alleging and collecting the obligation.

IV.

THE CLAIM OF APPELLEE FOR $732.22, THE AMOUNT PAID TO THE TRUSTEE, IS NOT A PROPER SET-OFF IN THE SUIT ON THE BONDS.

We turn now to the claim by the appellee in its amended answer (R. 36-37), and denied by the United States in its reply (R. 49-50), that appellee was entitled to a set-off of $732.22 of the amount chargeable to the taxpayer (Coast Wineries, Inc.) and consequently the appellee, United States Fidelity and Guaranty Company. This by reason of the fact that the United States refunded this sum to the Trustee in Bankruptcy when the tax for $3,162.56 was outstanding and unpaid by the Coast Wineries, Inc.

While no point concerning this has been made on appeal and the District Court was silent concerning same in its decision, findings of fact and conclusions of law and in the judgment entered by it, the matter may become of importance should this honorable court reverse the District Court in its action in dismissing the Government's suit. It is submitted that if such decision is reversed an order should issue from this Honorable Court instructing the District Court to enter judgment for the United States.

The $732.22 was an amount paid by the Trustee for wine tax stamps to be cancelled when certain wine

was sold by the Trustee in the Bankruptcy proceedings. The Trustee had overestimated the amount of wine tax stamps necessary for such wine and had purchased an excess of stamps in the amount of $732.22. The Trustee surrendered these stamps for cancellation and requested to be reimbursed for these unused stamps. The Comptroller General of the United States allowed such claim and refused to use this amount as set-off against the tax debt due from the Coast Wineries, Inc. since the unused stamps had been purchased by the Trustee. The Commissioner concluded, and it is believed this court will take judicial notice that this conclusion was correct and that money due the Trustee, which was property legally belonging to the bankrupt estate, could not be set-off against the tax liability of the Coast Wineries, Inc., the bankrupt. Thus, the United States Fidelity and Guaranty Company, appellee is not entitled to set-off for that amount.

V.

THE COURT ERRED IN DISMISSING THE SUIT AND NOT ENTERING JUDGMENT FOR THE AMOUNT SUED FOR BY THE UNITED STATES OF AMERICA.

The reason for the dismissal of this suit by the lower Court was based upon its finding of fact that there was an agreement between the attorneys for the

trustee in bankruptcy and Mr. Winter, Attorney for the Government, which resulted in the withdrawal of the original $9,387.21 wine tax claim, coupled with the understanding that the trustee would withdraw his objection to the two smaller claims, and that they would be allowed in the Special Master's report. We maintain this finding of fact was erroneous and not justified by the relevant and admissible evidence properly before the Court and consequently the conclusion of law that the order of Judge Webster, expunging and disallowing the lesser claim, was an adjudication upon the merits, is erroneous.

As herein before shown in the discussion of other points, the smaller claim was not properly before the Special Master or the Court and, therefore, the adjudication could not be on the merits, nor could it be conclusive on the United States of America. It is therefore respectfully submitted that the order of dismissal was erroneous.

CONCLUSIONS

1. From the above it is submitted that the decision of Judge Webster in the bankruptcy proceeding was not res judicata.

2. That the action of the officers in connection with this matter, properly in the record, does not constitute estoppel.

3. That the assessment of the tax and proof thereof in the record is prima facie evidence of the amount due from the bonding company and is not contradicted by the evidence, and that said tax remains outstanding and unpaid.

U. S. v. United States Fidelity & Casualty Co., 221 F. 27;

U. S. v. Fidelity & Casualty Co., 115 F. (2d) 475.

4. That the appellee, the United States Fidelity and Guaranty Co. is not entitled to a set-off for an amount equal to the wine tax stamp refund which was made to the trustee, and

5. That the order of the District Court should be reversed and set aside and instructions given by

this Court that a judgment be entered by the District Court in favor of the United States for the amount of this suit.

May, 1942.

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